

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

signature copy

No. 75-4197

No. 75-4198

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

FRED A. BERZON and GERTRUDE BERZON, Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE, Appellee.

ON APPEAL FROM DECISIONS OF THE UNITED STATES TAX COURT

REPLY BRIEF FOR APPELLANTS

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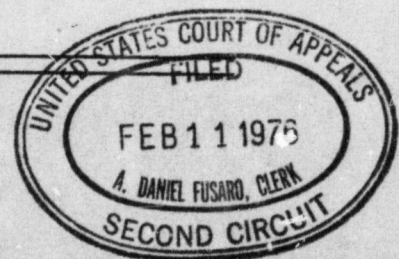
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1. The Government argues that the Tax Court's decisions in these cases should be affirmed, but for reasons significantly at variance from those set forth in the trial court's opinion. The Tax Court determined that gifts

of income interests in trusts created by Fred A. Berzon did not qualify for the \$3000 annual exclusion from gift tax, but expressly refrained from deciding whether or not the income interests were present interests. 63 T.C. 601, 616 (1975). The Government, on the other hand, asserts that the income interests were future interests. (Br. 11) */

We agree with the Government that a gift upon which the donor imposes conditions or restrictions limiting the donee's right to immediate enjoyment of income is a gift of a future interest. (Br. 10, 15) Therefore, in order to characterize the income interests in the Berzon trusts as future interests, there must be, in the trust instruments or surrounding circumstances, donor-imposed conditions or restrictions which impede, postpone, or defer the beneficiaries' rights to immediate enjoyment. Fondren v. Commissioner, 324 U.S. 18 (1945); Commissioner v. Diss-ton, 325 U.S. 442 (1945); Blasdel v. Commissioner, 478 F.2d 226 (5th Cir. 1973). Limitations which exist independently of the donor's control are not taken into account. Kieck-hefer v. Commissioner, 189 F.2d 118 (7th Cir. 1950) (legal disability of minor donees).

*/ "Br." refers to the Brief for Appellee, filed January 19, 1976, in the instant cases.

The Government cites no impediment to immediate enjoyment in the trust instruments per se. (There is none.) Instead, it refers to the terms and conditions of a contemporaneous stockholders' agreement governing ownership and disposition of the common stock of The Simons Co., Inc., of which 720 shares were donated to the Berzon trusts.

The stockholders' agreement, according to the Government, "froze the payment of dividends while the corporation was engaged in the 36-month pay-off of a deceased or selling party's shares." */ The Government also asserts that the agreement contained "substantial restrictions upon the trustee's power to sell the Simons stock and to purchase income-producing assets." (Br. 12) According to the Government, the effect of these alleged restrictions (although it is not clear whether that effect is produced by each restriction singly or by both in combination) is to

*/ In fact, as the Tax Court found, the negative covenant respecting dividends was in effect only for 36 months following the death of Joseph Berzon. Joseph Berzon's shares were repurchased by The Simons Co., Inc. after his death on December 10, 1967, and the purchase price paid to his estate over a 36-month period ending on March 1, 1971. Consequently, the negative covenant was not in effect on the dates the gifts of stock in The Simons Co., Inc., here in issue were made.

impede or burden the beneficiaries' rights to trust income to the extent that their income interests are not present interests.

The difficulty with the Government's argument is that, upon examination of the stockholders' agreement, one discovers no restriction on the trustees' power to sell stock of The Simons Co., Inc. Article FIFTH of the agreement states that no stockholder shall sell his shares "without the consent of the other stockholders, except as follows: *** ." The next two paragraphs expressly provide the circumstances in which a stockholder may transfer his shares without the consent of the other stockholders. The first sentence of paragraph "1.)" authorizes any stockholder to transfer shares by gift to or for the benefit of a relative. While the donee cannot freely dispose of the stock so acquired to any person, the third sentence of paragraph "1.)" provides:

Any stock transferred in trust for any beneficiary *** shall be redeemable by the corporation, provided it has the necessary surplus, at any time after the date of this agreement and shall be paid for in cash.

Since the corporation was a party to this agreement, it is evident that The Simons Co., Inc., was legally

obligated to repurchase and to pay for in cash any stock offered for sale by the Berzon trusts at the price determined under the agreement. This provision is anything but a substantial restriction on the trustees' power to sell. Its effect is entirely the opposite: it creates a captive purchaser for The Simons Co., Inc., stock owned by the Berzon trusts. Therefore, the trustees had, by reason of the stockholders' agreement, a greater ability to realize the value of The Simons Co., Inc., stock than they would have had if, without a stockholders' agreement, they attempted to sell a minority stock interest in a closely held corporation. The power to sell, coupled with the existence of an assured purchaser for The Simons Co., Inc., stock, substantiates the taxpayer's position that the income interests in the Berzon trusts are present interests. See Rosen v. Commissioner, 397 F.2d 245, 247 (4th Cir. 1968) rev'g 48 T.C. 834 (1967).

Moreover, the negative covenants set forth in Article SEVENTH of the stockholders' agreement cannot reasonably be construed as conditions or restrictions capable of converting a present interest into a future interest. The purpose and effect of these six covenants (including the

prohibition against the declaration or payment of dividends) were not to limit or impede the trust beneficiaries' receipt of income. They were inserted to protect the interest of any former or deceased shareholder whose stock is purchased in accordance with the agreement. It is a common and recognized practice for such creditors to impose conditions on corporate debtors preventing any action (i.e., sale of assets, merger, recapitalization, salary increases, or dividend payments) which could deplete corporate resources or diminish the debtor's ability to pay its obligation. The strictures of Article SEVENTH were thus imposed by the stockholders as potential creditors of the corporation for their own protection, not by them as potential donors of corporate stock in order to limit the donees' interests.

Since the restrictions are themselves contingent and exist independently of the donor-donee relationship, it is, we submit, fallacious for the Government to rely on them to transform what would otherwise be a gift of a present interest into one of a future interest. As articulated by the Court of Appeals for the Seventh Circuit in Kieckhefer v. Commissioner, supra, at 122, the fallacy lies

in "the failure to distinguish between restrictions and contingencies imposed by the donor ***, and such restrictions and contingencies as are due" to circumstances not controlled by the donor. Only the former -- donor-imposed restrictions -- are pertinent in determining whether a gift is of a present or future interest.

Further, the fact that trustees had the unfettered right to sell The Simons Co., Inc., stock at any time for cash and to reinvest the proceeds in income-producing property vitiates any incidentally adverse effect of the Article SEVENTH covenants. Even though the corporation could be temporarily disabled from paying dividends, that disability would not prevent the trusts' realization of current income from other sources. Therefore, we submit that the alleged restrictions and limitations of the stockholders' agreement cannot transform the present income interests created by the Berzon trust instruments into future interests.

2. The Government also argues that the value of the income interests in the Berzon trusts cannot be ascertained by reference to actuarial tables because, quoting Learned Hand, "*** the circumstances at bar are too far

afield from the experience which the tables record and on which their forecasts are made." (Br. 14, citing Commissioner v. Maresi, 156 F.2d 929, 931 (2d Cir. 1946) */)

The "too-far-afield circumstances" alleged by the Government are (a) that The Simons Co., Inc., did not declare and pay dividends (Br. 14), and (b) that the donor, through the stockholders' agreement, substantially restricted the trusts' rights to income, thereby rendering the income interests incapable of valuation and destroying their status as gifts of present interests. (Br. 15)

For the reasons set forth in our initial brief, we submit that the corporate dividend policy and practices of The Simons Co., Inc., were not subject to the absolute

*/ The Maresi case, supra, does not support the Government's case. There the Tax Court was called upon to determine the value for estate tax purposes of a future interest dependent not only on a divorced woman's life expectancy but also on the likelihood that she would remarry. The Tax Court determined that value by reference to actuarial tables reflecting, for workmen's compensation purposes, the likelihood that widows would remarry. Recognizing that such tables would not necessarily produce an accurate result, this Court nevertheless sustained use of actuarial tables on the grounds that "We are dealing with speculation as to the future on a subject which at best admits of no accurate determination. **** The one sure way to do injustice in such cases is to allow nothing whatever upon the excuse that we cannot tell how much to allow." 156 F.2d at 931.

control of the donor and thus have no relevance to or bearing on the values of income interests in the Berzon trusts (Brief for Appellants, 16-32) In accordance with gift tax regulations, section 25.2512-5, these values are to be determined by reference to the Treasury's standard actuarial tables.

Robinette v. Helvering, 318 U.S. 184 (1943), cited by the Government, is not authority to the contrary. Robinette does not hold that uncertainty concerning the income flow to be derived from a trust's corpus makes valuation of an income interest by reference to actuarial tables improper. Rather, that case involved the difficulties encountered in valuing a reversionary interest which depended "not alone upon the possibility of survivorship but also upon the death of [a preceding life tenant] without issue who should reach the age of 21 years." 318 U.S. at 188. The Supreme Court did not even consider the character of the assets transferred in trust. The terms of the trust -- the express conditions and limitations on the reversionary interest -- made that interest insusceptible to actuarial valuation. Since the Berzon trust instruments did not limit or restrict the beneficiaries' rights to trust income, citation of Robinette is inapposite.

The Government also argues that the stockholders' agreement limits or restricts the beneficiaries' income rights, and therefore makes the value of the income interests unascertainable. The limitations and restrictions are the alleged 36-month "freeze" on dividends and the restraints on sale, the same restrictions that the Government argues transform the income interests into future interests. (Br. 15) This position is consonant with our view that requiring an income interest to have an "ascertainable value" adds nothing to the criteria for a present interest articulated by the Supreme Court in Commissioner v. Diss-ton, supra. (Brief for Appellants, 32-35) As demonstrated above, the donor did not, in the stockholders' agreement or elsewhere, impose any conditions or limitations on the beneficiaries' rights to enjoy trust income. Any uncertainties or disabilities affecting their beneficial enjoyment of the income existed or were created independently of the donor-donee relationship in question. Therefore, in accordance with Kieckhefer v. Commissioner, supra, cited by the Government, these uncertainties or disabilities cannot convert the income interests into future interests and do not prevent valuation of these interests by reference to actuarial tables in accordance with the regulations.

3. Fundamentally, the Government's argument -- that the income interests are future interests and that their value is not ascertainable -- is predicated almost wholly on the Government's claim that the stockholders' agreement imposes substantial limitations on the beneficiaries' rights to trust income. As indicated above, we construe the stockholders' agreement to impose no such limitations on the income interests. While the stockholders' agreement was before the Tax Court, that court did not reach any conclusions concerning the effect of its provisions on the income interests in the trusts. */ On the contrary, the Court concluded, without advertent to the stockholders' agreement, that "*** the rights to income of the eight beneficiaries come within the literal requirements of section 2503(b) and (c)," so that it could "assume, without deciding, that the gifts of the income interests were gifts of present interests." 63 T.C. at 616.

Consequently, in order to sustain the Government's position for the reasons set forth in its brief,

*/ The Court's comments on the agreement were limited to a determination that the obligation of The Simons Co., Inc., to redeem stock held by the trusts did not assure that the minor beneficiaries of the trust would realize the benefit of appreciation in the value of the stock, if any. 63 T.C. at 619-620.

this Court is called upon to construe the stockholders' agreement even though the Tax Court did not. While there can be no doubt that this Court has the power to determine the effect of the stockholders' agreement as a matter of law, the situation is comparable to the one presented in Clark v. United States, 267 F.2d 501 (1st Cir. 1959). There the Court of Appeals for the First Circuit was asked to decide whether a section of the New York Real Property Law prevented a donor-trustee from exercising a power conferred upon her by the trust instrument. The issue had not previously been considered by the district court. In vacating the judgment and remanding the case, Judge Magruder stated:

While we no doubt have the power to go ahead and dispose of the case finally, *** yet as a matter of discretion we think that the judgment of the District Court should be vacated and the case remanded to that court for consideration in the first instance of this new argument raised by the taxpayers with respect to the New York law. Perhaps some of the ambiguities which cloud the case can be clarified by factual evidence proving, for example, the nature of the corpus and the intention of the parties to the trust indenture. 267 F.2d at 507.

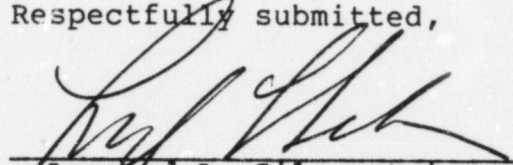
As stated above, we submit that the stockholders' agreement imposes no substantial restrictions on the income interests in the Berzon trusts. This Court certainly has

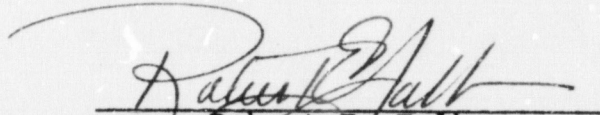
the power to so decide. But in light of the heavy reliance that the Government now places on the terms of the stockholders' agreement to support affirmance of the decisions below, the fact that the Tax Court considered the agreement's effect on the income interests only in passing, and the absence of evidence bearing on the parties' intentions respecting the impact of the agreement's terms on the Berzon trusts, any ambiguities in its terms may best be resolved by remanding these cases to the Tax Court.

CONCLUSION

For the reasons stated in the Brief for Appellants and in this Reply Brief, the decisions of the United States Tax Court should be vacated and these cases remanded for further proceedings consistent with the allowance of annual exclusions from Federal gift tax or, in the alternative, for further proceedings to ascertain the effect that the terms of the stockholders' agreement may have on the allowance of such annual exclusions.

Respectfully submitted,


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CERTIFICATE OF SERVICE

It is hereby certified that service of this reply brief has been made on opposing counsel by mailing four copies thereof on this 10th day of February, 1976, in an envelope with postage prepaid, properly addressed to him as follows:

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